IN THE

United States Circuit Court of Appeals

For the Ninth Circuit

SCANDINAVIAN-AMERICAN BANK,
a Corporation,
Petitioner and Appellant,

vs.

R. L. SABIN, Trustee of the Estate of
D. Sondheim, Bankrupt,
Trustee and Respondent.

In the Matter of D. Sondheim, Bankrupt.

BRIEF OF APPELLEE.

Petition for Revision of and Appeal from a Certain Order and Judgment of the United States District Court for the District of Oregon.

SIDNEY J. GRAHAM,
Attorney for Petitioner and Appellant.

SIDNEY TEISER,
ROSCOE C. NELSON,
Attorneys for Trustee and Respondent.

BOYER PRINTING COMPANY, PORTLAND, OREGON

INDEX

IN THE

United States Circuit Court of Appeals
For the Ninth Circuit

SCANDINAVIAN-AMERICAN BANK,
a Corporation,
Appellant

vs.

R. L. SABIN, Trustee of the Estate of
D. Sondheim, Bankrupt,
Appellee

In the Matter of D. Sondheim, Bankrupt.

Petition for Revision of and Appeal from a Certain Order and Judgment of the United States District Court for the District of Oregon.

BRIEF OF APPELLEE.

STATEMENT OF FACTS.

There is no controversy with regard to the facts in this case. They will be found succinctly stated in the report of the Special Master (Transcript of Record,

pp. 33-36) and still more tersely yet adequately stated in the opinion of the District Judge, Hon. R. S. Bean (Transcript of Record, pp. 77-78.)

For the convenience of the Court, however, we will here condense the Statement made in the Appellant's Brief, adding—because of the fundamental importance in this, as in other controversies, of a clear understanding of the situation—a few points which the Appellant will not dispute and which are deemed vital by the Appellee.

About Oct. 23, 1914, D. Sondheim, the bankrupt, owed the Scandinavian-American Bank, Appellant, herein, the sum of $2,600.00. He applied at that time for a further loan of $2,600, which he told the bank he expected to use in *part* payment of the purchase price of $5,680.00 for some merchandises known as the Pallay stock. The bank advanced the $2,600.00, and Sondheim executed an agreement to the bank by which he undertook to protect it and set forth that he held title to the Pallay stock, as trustee for the bank, insofar as the holding of such title should be necessary to pay the bank for the money due it. The agreement further provided that Sondheim should keep an account of sales and turn over to the bank daily *one-half* of the preceding day's receipts until the $2,600.00 then advanced and the $2,600.00 formerly owing should have been repaid.

Sondheim did not (and the bank acquiesced in the omission) make the daily payments, but verbally agreed to give the bank $500.00 per week until the indebtedness was discharged.

On Nov. 13, 1914, a few hours before the levy of the

attachment, the bank took possession of the stock, and three days thereafter proceedings in involuntary bankruptcy against Sondheim were instituted.

So far as this statement goes it is correct. Among other things, however, it omits these facts:

First. The bank never had title to or ownership of the stock of goods—title passed directly from the trustee in bankruptcy in the Pallay matter to Sondheim, and the business was continued and conducted by Sondheim as his own, the public generally and creditors of Sondheim in particular having no notice of any character as to the secret arrangement between Sondheim and the bank. The agreement with Sondheim was never recorded.

Second. After the agreement with the bank, Sondheim bought and sold goods, controlled the business in the regular way, deposited the proceeds of his sales to his individual account in the Scandinavian-American Bank, and checked on the account as he willed, without let or hindrance on the part of the bank.

Third. The bank did not take immediate possession under the agreement, the interval being some three weeks. It was only after Sondheim had disappeared and his whereabouts had remained unknown for several days, that the bank sent its agent to Sondheim's store—a few hours before the levy of an attachment.

QUESTIONS OF LAW INVOLVED.

The Appellant has carefully avoided throughout the history of this matter any clear-cut statement of exactly what it claims to be the proper and legal effect of the agreement between it and Sondheim. Its position, as amended from time to time and after the abandonment of other equally ingenious and equally unsound contentions, is now apparently: (a) that the agreement is a conditional sale agreement, Sondheim to get title when he had finished paying the bank all that was due it; (b) that Sondheim held the stock in trust for the bank, the title being in the latter; (c) that the agreement amounts to a chattel mortgage to secure the bank the repayment of present and past advances; (d) that in any event the trustee could not attack the conveyance.

The brief filed by the Appellant argues all of these contentions and dogmatically and with sublime disregard of consistency, terms the considerations urged as to each "conclusive" and "fatal to the trustee's case"—the instrument is thus, according to Appellant, *plainly* a conditional sale agreement, *clearly* a trust certificate, and *surely* a chattel mortgage.

We will, for the sake of clarity, take up the contentions of Appellant in the order adopted by it in its Brief.

I.

DID THE TITLE "REMAIN" IN THE BANK? CONDITIONAL SALE OR TRUST?

At page 12 of its Brief, the Appellant begins its argument, which is in three principal divisions, by setting out as the heading of division I,

> "Under the terms of the agreement the title to the merchandise remained in the bank."

As we understand the ordinary connotation of the word "remain," this heading would pre-suppose as a fact that the title had at some time been in the bank. The facts as found by the Special Master—and they were not attacked on appeal—are as follows: (Transcript of Record, pp. 34-35.)

> "During the time Sondheim was in possession of this stock he was so as sole and exclusive owner; he paid much more for the stock than the sum secured from the bank; *the muniment of title was his and not the bank's;*" etc.

Sondheim bought the "Pallay" stock from the trustee in the "Pallay" bankruptcy matter. The Scandinavian-American Bank was not known in the transaction. It never had title to the property and it is not

clear, therefore, how it can be contended that title always "remained" in it.

The Appellant argues that the cashier of the bank having testified that Sondheim told him that the bank would have title, but that Sondheim would want to handle the goods and that according to his (the cashier's) understanding, after the bank got back the $2,600.00 it was advancing and the $2,600.00 formerly due it, the bank would have nothing more to do with the matter, and the title would be Sondheim's—the agreement construed in the light of that testimony "is clear and plain," i. e., that the title "remained" in the bank and that the transaction thus amounted to a "conditional sale," and that the contract being a contract of conditional sale, was not required to be recorded under the laws of the State of Oregon.

We invite the Court's attention to the testimony of the cashier of the bank in this regard: (Transcript of Record, pp. 60-61.)

> "Q. Now, from whom did Sondheim purchase this stock of goods? The stock in controversy on 6th St.?
>
> A. I understood he purchased it from Mr. Sabin?
>
> Q. In the bankrupt proceedings of D. Pallay & Co.?
>
> A. Yes.
>
> Q. Did you have any conversation with the seller of the stock of goods?
>
> A. No.
>
> Q. You did not get any bill of sale from the seller, or anything of that sort, did you?

A. No.

Q. You knew the stock was being turned over to Sondheim by whoever was selling it?

A. Our understanding was that the stock would be in our name, that we would own title to it until we were paid.

Q. Did you take a bill of sale from the seller or do anything to get the title?

A. No.

Q. You understood that was the effect of this agreement which you had with Sondheim?

A. Yes.

Q. You had no agreement with the seller of the stock?

A. No.

Q. You knew that Sondheim was paying considerable more than $2,600.00 for the goods, didn't you?

A. Yes.

Q. Did he tell you what he was paying?

A. I think he did.

Q. About $6,000.00?

A. I think so?

Q. Did you investigate the stock to see whether it was worth what he said he was paying for it?

A. No.

Q. The bank didn't put its name on the store, or anything of that character, did it?

A. No.

Q. Sondheim ran the business just like he ran his other stores, did he?

A. Yes.

This testimony sufficiently shows that the bank never had title to the stock, and the agreement cannot be construed as a conditional bill of sale.

If the transaction were a conditional sale Sondheim would owe the bank nothing. The contract would amount merely to an agreement by which Sondheim might purchase the stock from the bank and procure title to it from the bank for $5,200.00. The bank's former loan of $2,600.00 would have been wiped out and there would be no obligation on Sondheim to repay it the amount formerly due or the $2,600.00 advanced at the time of the purchase. It is manifest that no such curious relationship was intended by the parties, nor can it be inferred from any fair construction of the agreement.

However, even if by any fantastic construction the contract could be treated as a conditional sale, it would still be invalid. It is conceded that the bankrupt remained in possession of the stock, dealt with it as his own; deposited the proceeds of sales to his individual credit and checked on them as he saw fit. The District Court of the United States for the District of Oregon has expressly declared void a conditional sale agreement where the seller permitted such a course of conduct. See

In re Rasmussen's Estate, 136 Fed. 704.
In re Roellich, 223 Fed. 687.

"But," argues the Appellant, "even if the agreement did not constitute a contract of conditional sale in the strictest sense, there is a species of indefinable trust relationship and the merchandise is not part of the bankrupt estate, but belongs to the bank until it gets out of it not only the $2,600.00, constituting less than half what Sondheim paid for the stock, but the additional

$2,600.00 which he had been owing the bank a year or more."

In support of this proposition the Appellant cites

In re Cattus, 183 Fed. 733, and
Black on Bankruptcy, p. 807,

to the effect that where a bank purchases, or advances to a merchant money for the purchase of a stock of goods, and the merchant executes a trust receipt by which he agrees to hold the goods in trust as the property of the bank, "but with liberty to sell the same in the course of trade and binding him to pay over the proceeds of such sale as fast as received until the advances are repaid," the title to the goods does not vest in the merchant until the advances have been repaid.

It would not be productive of any advantageous results to enter into a discussion of whether or not the doctrine of this type of case is applicable in Oregon, because the facts in all the cases we have examined are clearly distinguishable from those in the instant case, and we have no occasion here to dispute the accuracy of the conclusions there reached. It will be apparent from an examination of the Cattus and other cases, for instance, that

(a) The bank was the *owner* of the property.

(b) The bank had paid drafts and *purchased* the bills of lading for the goods.

(c) The bank paid the *whole* of the purchase price.

(d) The goods were then turned over to the indi-

vidual under an agreement that the individual should sell them for the account of the bank and turn over *all* the proceeds to the bank.

(e) The bank required the merchant to live up to the last mentioned arrangement.

(f) The goods were insured in the name of the owner—the bank.

To claim that such a doctrine, whether sound in any case or not, is applicable to a case like the instant one, where the bank advanced only *part* of the purchase price, and *permitted* the merchant to conduct the business as his own, buying and selling in the ordinary course of trade, depositing the money to his individual credit, checking on it as he pleased, rendering no account, etc., is a monstrous perversion of a doctrine supposedly based upon the principles of fair dealing.

In determining the validity of the asserted "lien" the laws and practice of the State of Oregon will be followed, and neither the statutes of Oregon nor the decisions of that state countenance any such thing as a "trust" by which a man can do business in his own name, deal in a shifting stock of goods, use the proceeds as he sees fit, and when his creditors seek to have his assets applied to the payment of his debts, claim immunity from attack by virtue of the secret existence of an unrecorded agreement, in the execution of which the debtor has then been left in uncontrolled possession and use of his assets.

The Appellant confines itself to a discussion of the "language" of the agreement. It is believed that this

Court will be at least equally interested in the manner in which the transaction was *actually carried out,* and an examination of the *acts of the parties* will instantly condemn the agreement as in its nature necessarily and essentially a fraud upon the creditors in the sense of the settled law of the State of Oregon and of other jurisdictions, that any transaction by which a person in possession is given the benefits of unencumbered property while his creditors are prevented from collecting their claims, is, without regard to the intention of the parties, fraudulent as a matter of law. It will be quite clear from a reading of In re Cattus, and from an inspection of the section quoted by Appellant from Black on Bankruptcy that neither that Court nor that text-writer, had in mind sanctioning a course of conduct on the part of a bank entering into an agreement of the nature pronounced valid, but in actual practice, permitting the individual to make sales as he saw fit, and use the proceeds *for his own purposes, without* accounting therefor to the bank. In any event a fair reading of the opinion in In re Rasmussen Estate, 137 Fed 704, and In re Roellich, 223 Fed. 687, will render it clear that in Oregon at least such an arrangement is void as to creditors whether it is called a conditional sale, mortgage, contract, trust, or by whatever nomenclature the ingenuity of counsel may devise.

II.

IS THE CONTRACT VALID CONSIDERED AS A CHATTEL MORTGAGE?

The Appellant, arguing this contention, sub-divides its arguments into four parts. The first of these minor sub-divisions is expressed by Appellant as follows:

> (a) "A mortgagor may remain in possession of mortgaged property, selling it at retail, without rendering the mortgage void."

This declaration is distinctly incorrect and misleading, unless there be added "*provided* he is in possession as agent of the mortgagee, and the *proceeds* of the sales are *accounted* for and turned over to the mortgagee to be *applied* upon the mortgage indebtedness."

The Appellant cites Oregon cases, with the doctrine of which it must be assumed to be familiar, rendering this clear, and the conclusion follows that it understands the significance of this proviso, but omitted it because its acts in the instant case were in direct contravention thereto.

Oregon cases holding in accordance with the contention of the trustee here are referred to by Appellant, but glibly explained away on the theory that the mortgage in those cases was declared void because *"for the benefit of the mortgagor.* The temerity of Appellant

in this regard is little less than startling, when it is borne in mind that such is precisely the situation in the instant case, according to the findings of the Special Master, which Appellant does not attack!

Thus, Appellant avoids Orton vs. Orton, 7 Ore. 748, holding such a chattel mortgage invalid because, says Appellant, in that case, "the mortgagor applied the proceeds realized from the daily sales to his own use."

The audacity of this "distinction" will be appreciated when reference is had to the opinion of the Court below, wherein, referring to the provision of the instrument with reference to the account of sales, the learned Judge remarked:

> *"This latter clause (i. e., accounting, etc.), was not observed, but Sondheim bought the stock of goods, assumed control of it, sold and disposed of it in the regular course of business, deposited the proceeds to his individual account in this bank and checked them out as he saw proper."* (Transcript of Record, p. 78.)

The Master found the same facts and there is no appeal from these findings. It is manifest, therefore, that the conduct of the transaction in the instant case comes precisely within the inhibition of the Oregon courts.

Bremer vs. Fleckenstein, 9 Ore. 274, gives Appellant no concern, because it quotes the Court in that case as

saying: "We find the mortgagor in reality under no more restraint than if the mortgage had not been in existence." If the mortgagor had any more freedom than Sondheim had, as above set forth, the Appellant has not pointed out the particulars in which such ultra-liberty appears.

See to the same effect:

Aiken vs. Pascul, 19 Ore. 493;
Fisher vs. Kelly, 13 Ore. 1.

Appellant then argues that the "later" Oregon decisions fully uphold the right of a mortgagor to remain in possession, selling at retail. Again, we assert that the significant proviso with reference to the actual accounting not only being required in the mortgage itself, but actually followed in the course of the transaction, is a *sine qua non* of validity.

The first of these "later" decisions cited by Appellant is Currie vs. Bowman, 25 Ore. 364, in which the Supreme Court distinctly found (see pages 383-384) "that the mortgagor *did account for and pay over the* proceeds of the stock." Because of the selling of a few small items on credit the mortgagee took possession of the stock and proceeded to sell it himself. The Court said that the mortgagor "was *vigilant,*" and that his conduct showed he intended the terms of the mortgage "to be strictly observed, and that any departure therefrom would not be tolerated."

Just what aid or comfort Appellant gathers from

that decision is not apparent. Appellant was the reverse of vigilant, according to the learned Judge of the District Court, and according to the Special Master. There is no pretense of an account of sales and no restriction of any character imposed upon Sondheim in his utilization of the proceeds.

The next "later" decision cited is Sabin vs. Wilkins, 31 Ore. 450, where, says the Appellant, "the Court again upholds the chattel mortgage which permits the mortgagor to remain in possession selling at retail." In that case the Supreme Court distinctly pointed out (page 458) that the mortgage "permits the mortgagor to retain possession of the property, but *expressly forbids the sale or disposal of it, or of any part thereof by the mortgagor.* The testimony showed that the mortgagee herself took charge of the business, took all of the receipts and disbursed them herself. There was no testimony whatsoever tending to show that the mortgagor sold anything from the store himself or that he obtained or used any of the proceeds of the sales. It will be quite apparent from the most cursory reading of this decision that it was based particularly on the fact that the mortgagor was not permitted to conduct the business in the usual course, as before, or to use or appropriate the proceeds of the sales for his own use and benefit. In fact it is distinctly stated at page 456 that such a mortgage should be held invalid, whenever it appears "either upon the face of the mortgage or by *parole evidence aliunde,* that the mortgagee of personal property has given the mortgagor unlimited power and authority to dispose of the property in the usual course of trade for his own use and benefit." And the Court, further discussing the

matter, says, in substance, that whether the objectionable feature appears in the mortgage itself, or where made by independent agreement, express or implied, either at the time the mortgage was entered into or subsequently thereto, the mortgage is thereby converted into an instrument for the benefit of the mortgagor and is fraudulent, and void from the time such purpose is promoted.

We assert, without fear of successful contradiction, that there has been no deviation from the doctrine of Bremer vs. Fleckenstein, 9 Oregon 266.

The latest decision of the Supreme Court of Oregon on this subject indicates firm adherence to the fundamental importance of the proviso with regard to the actual conduct of the parties in the operation of the transaction. We refer to the case of Gregg vs. Mueller, 133 Pac. 94. In that case a mortgage was executed upon a shifting stock of goods, the instrument requiring the mortgagor to account for sales. In actual practice, however, the mortgagor was permitted to make sales without accounting for the proceeds, and the Court held that the mortgage was fraudulent and void. It is true in that case the element of actual fraud was present, but the decision fairly enunciates the following principles of law as applicable to chattel mortgages on shifting stocks of goods in the State of Oregon.

That a mortgage on a shifting stock, where possession remains in the mortgagor with power of disposition, in the usual course of trade, is void, unless the mortgage contains a provision for an accounting to the mortgagee and application of the moneys in payment of the debt

secured, and such provision for accounting is made in good faith and no laches occurs on the part of the mortgagee in the shape of permitting the mortgagor to deviate from the strict terms of the mortgage with regard to such accounting and application of the proceeds.

Accordingly, the Court held that although the mortgage on its face was a valid mortgage in that it provided for an accounting, yet, inasmuch as the mortgagee by reason of his laches, permitted the mortgagor to neglect such accounting he thereby converted the mortgage into an instrument for the benefit of the mortgagor, thus raising an indisputable presumption of fraud.

It is also a fact, which we believe this Court will not regard as of minor significance, that this contention on the part of the Appellant as to the effect of the decision of the Oregon Supreme Court was presented to District Judge Bean, himself formerly a member of the Oregon Supreme Court and a participant in some of the decisions referred to, and this learned Judge disagreed with Appellant's comprehension of these decisions, stating his disagreement in this language: (Transcript of Record, p. 79.)

> * * * "as I understand the decisions of the Oregon Courts, a mortgage on a shifting stock of goods where the mortgagor is permitted to remain in possession and sell and dispose of it in the regular course of business, appropriate to his own use, or use as he may see proper, is void as to creditors, and therefore this instrument, I take it, is a void instrument

> and did not give the bank any preference over the other creditors of this concern."

Appellant, however, lays as a flattering unction to its soul, the finding that "the agreement was given in good faith and to secure a bona fide debt." (Appellant's Brief, p. 18.) The vice of this and similar transactions lies, however, not in the question of the *subjective* state of mind of the mortgagee, but in the *effect* upon the creditors and those who have a right to object to any such false situation as would arise from the rendering possible for a creditor by calling itself secured, to permit a debtor the retention of his property and its conversion into money, with the immunity of the money from the claims of his creditors, while not requiring that it be applied in reduction of the secured claim.

This was distinctly pointed out by the United States Supreme Court in Knapp vs. Trust Company, 216 U. S. 545, where that Court, applying Wisconsin statutes *identical* in terms with Sections 799 and 7407 Lord's Oregon Laws, held that *notwithstanding a finding of the existence of good faith,* a mortgage which permitted the exercise of control by the mortgagor over property left in his possession was void as to creditors.

The Circuit Court of Appeals for the Ninth Circuit has furthermore stated its understanding of the doctrine of the Oregon cases, in Peterson vs. Sabin, 214 Fed. 234, in the following language:

> "That court (the Supreme Court of Oregon) has distinctly held that where a mortgagee has given the mortgagor un-

> limited power to dispose of the mortgaged property for his own use, the mortgage is void as to creditors of the mortgagor, *even if there was no actual fraudulent intent on the part of either* of the parties to the mortgage." (Italics ours.) Citing Orton vs. Orton, 7 Ore. 478; 33 A. S. R. 717; Jacobs vs. Ervin, 9 Ore. 52.

And while the Special Master does acquit the bank of any actual intention to defraud the creditors, he makes this just and pertinent criticism of the flagrant course of the bank from the standpoint of creditors: (Transcript of Record, p. 41.)

> "In the first place, this mortgage never was recorded, which, in itself, is a prominent piece of vice, and the manner in which the parties conducted themselves under the mortgage cannot be justified upon any ground whatever. Sondheim was in the sole and exclusive possession as the owner; he sold as he pleased; bought as he pleased; rendered no account whatever to the bank, though it was stipulated that he should; the money derived from sales was deposited to his general account in the same bank and checked out by him unrestrained; indeed, the slight protective measure agreed upon aliunde the mortgage, that he should pay on his notes \$500.00 per week, was ignored and finally charged by the bank against his general account, perhaps from moneys received by him from other sources. *As I have pointed out, there was not an indication, either off or on the record, by which any person could have been warned that the*

> *bank had the remotest claim upon this store, and hence it was, perhaps, that Sondheim was able to secure credit for merchandise running into the thousands of dollars after this mortgage was given. Whether so intended or not, this was a fraud, beyond dispute, and I do not think creditors are, or should be, bound by an arrangement fraught with such entire absence of candor or open dealing. The effect of it was to conceal from the creditors completely the fact that Sondheim's property was encumbered, to enable him to sell and dispose of it regardless of that fact, and thus to hinder and delay them. To this the bank was a party and must be held to have intended what its attitude accomplished."*

The next minor sub-division is thus stated by Appellant:

> "(b) The presumption of fraud raised by Section 799, L. O. L., is a disputable one and is overcome by evidence that a mortgage is executed in good faith and for a valuable consideration."

We shall deal very briefly with this contention, which seeks to avoid the consequences of the *failure to record* the instrument, asserting that that failure creates not a conclusive but a disputable presumption of fraud, and that inasmuch as there was a finding of good faith, the agreement is left valid and binding. The trustee did not base his claim of invalidity on the mere "failure to record." The chattel mortgage, if the agreement is a

chattel mortgage, is void because in its operation it was a fraud upon the creditors for reasons pointed out fully in the preceding sub-division, and as stated by the U. S. Supreme Court in the case of Knapp vs. Trust Co., 216 U. S. 545,—i. e., the good faith of the mortgagee, who permits such a fraud upon the general creditors, does not confer sanctity on the transaction.

The third minor sub-division is stated by Appellant as follows:

> "(c) Possession of mortgaged property by a mortgagee under an unrecorded chattel mortgage before the lien of any creditor attaches, makes such a mortgage good against every one."

Proceeding to argue the correctness of this statement, Appellant remarks that the decisions are numerous on the point, and cites three, and one text writer. This Court, we apprehend, is particularly interested in what the Supreme Court of Oregon says on the subject. The Appellant calls attention at page 20 of its Brief to the case of Cook vs. Cooper, 18 Ore. 142, which deals with the right of a mortgagee to take possession of mortgaged property after default, etc., and which is not even remotely in point, and the Appellant carefully refrains from calling the Court's attention to the case of Pierce vs. Kelly, 25 Ore. 95, in which Mr. Justice Bean gave a clear exposition of the meaning of the requirement of the Oregon statutes with regard to an immediate change of possession as a pre-requisite to the

validity of a transaction based on an unrecorded instrument.

Said Judge Bean:

> "By sub-division 40 of section 776 of Hill's Code it is provided, in substance, that every mortgage of personal property, capable of immediate delivery, which is not filed or recorded, shall be presumptively fraudulent as to creditors, of the mortgagor unless it is accompanied by an *immediate* delivery and be followed by an *actual* and *continued* change of possession. In this case the mortgage was not filed or recorded, and hence this presumption would attach unless there was an actual and continued change of possession of the mortgaged property. The change of possession necessary to overcome and rebut this presumption *must be actual,* and not merely constructive or legal; it must be effected in a way *calculated to give notice to the public* that there has been a change in the ownership of control of the property, and a mere constructive possession, or one taken by words and inspection, will not satisfy the statute. Cobbey, Chattel Mortgages, Sec. 497. The possession of the mortgage must be *exclusive,* and *accompanied with such outward acts and indicia of ownership* as will apprise the public, and particularly those who are accustomed to deal with the parties, that the goods have changed hands, and the possession has passed from the mortgagor to the mortgagee. There must be a complete change in the dominion and control over the property, and a concurrent or

> joint possession with the mortgagor is not sufficient (McKibbin vs. Martin, 64 Pa. 352, 3 Am Rep. 588; Kitchen vs. Reinsky, 42 Mo. 437,) although where there is such a change in the possession and control there perhaps can be no legal objection to the employment of the mortgagor to render services in and about the business, as any other agent or employe."
>
> (Italics ours.)

The cashier of the bank admitted that the bank did not give any notice of its claim on the store or stock; that Sondheim conducted the store exactly as he conducted his other stores; that Sondheim made other purchases of stock on which the bank kept no check; that the bank did not pay the salary of any employee of Sondheim's; that Sondheim made no reports; that no check was kept on the proceeds of sales, but Sondheim was given unlimited power of disposition thereof.

There is no question under this testimony that the bank did not have possession of the stock at any time before November 13, 1914, as possession is to be understood in the light of Judge Bean's construction of the statute. When it did take possession, a few hours before attachment, its possession was not open, exclusive or notorious, nor was it taken or continued in such a manner as to give its possession these attributes.

On November 13, 1914, when Sondheim's disappearance had remained unexplained for days, the bank, after becoming apprised of the fact that suits had been instituted by creditors against Sondheim and writs of attachment issued, a few hours before the levy of attachments was made placed a man named Eftland in charge of the

stock (Special Master's Report, Transcript, page 35,) all other original employees of Sondheim remained. The only change in the situation was the addition of Eftland to the corps of clerks. This was the first suggestion of any change of possession. This took place, it is conceded, three weeks after the execution and delivery of the chattel mortgage or agreement under attack. The Orgon statutes in both instances precisely and explicitly declare that the only change of possession which applies is the *"immediate."* change, i. e., one made promptly upon the execution and delivery of the instrument. The failure to record, therefore, was not cured by this belated taking of possession.

Inasmuch as this question must be determined in the light of the statutes of the particular state in which the transaction occurs, decisions from other states, unless the statute of such state contains precisely the same terminology as the Oregon statute, are not instructive. The truth of this observation will be apparent from a consideration of the case of Martin vs. Halloway, 16 Idaho 513, cited in this connection by Appellant at page 21 of its Brief, as authority for the doctrine that possession cures the defect if it occurs prior to the acquiring of any specific lien.

An examination of the Idaho statute under review in that case will show that the word "immediate" used in the Oregon statute is omitted. It provides that change of possession cures a failure to record, but this change is *not* required to be an immediate one. The case, therefore, is, of course, not in point in Oregon.

For the convenience of the Court we append significant sections of the Oregon Code:

Sec. 799 (sub-section 40) L. O. L.:

> "Every sale of personal property, capable of *immediate* delivery to the purchaser, and every assignment of such property, by way of mortgage, or security, or upon any condition whatever, unless the same be accompanied by an *immediate delivery,* and be followed by an actual and continued change of possession, creates a presumption of fraud as against the creditors of the seller or assignor, during his possession, or as against subsequent purchasers in good faith and for a valuable consideration, disputable only by making it appear on the part of the person claiming under such sale or assignment that the same was made in good faith, for a sufficient consideration, and without intent to defraud such creditors or purchasers; but the presumption herein specified does not exist in the case of a mortgage duly filed or recorded as provided by law;"

Section 7407:

> "Every mortgage, deed of trust, conveyance, or instrument of writing intended to operate as a mortgage of personal property, either alone or with real property, hereafter made, which shall not be accompanied with *immediate* delivery and followed by the actual and continual

> change of possession of the personal property mortgaged, or which shall not be recorded as provided in Section 7405, shall be void as against subsequent purchasers and mortgagees in good faith and for a valuable consideration of the same personal property, or any portion thereof."

(It will be borne in mind that this instrument was never recorded.)

We wish to emphasize in this connection that the *only effect* even immediate change of possession would have had, would be to cure a *failure to record.* Appellant overlooks the fact that recordation of this instrument would *not* have given it validity. In the case of Bremer vs. Fleckenstein, and in the other Oregon cases in which the doctrine of the Bremer case was approved and followed, the *mortgage was actually recorded,* but was nevertheless held to be void for the reasons already referred to at length.

The precise contention made by Appellant in this connection was adversely disposed of by District Judge Bean in the case of Schaupp vs. Miller, 206 Fed. 255. The facts in the Schaupp case were much stronger against the trustee than in the instant case, the mortgage there having been recorded and the possession having been taken by the mortgagee two months before the adjudication in bankruptcy. Nevertheless, inasmuch as by the acts of the parties the mortgagor had been permitted to continue in possession, selling the goods at retail in the usual course of business and not

accounting for the proceeds, the Court held that the mortgage was void and that the invalidity was not cured by the taking possession on the part of the mortgagee some two months before the adjudication.

That the point raised by Appellant here is clearly involved and fully considered in the Schaupp case is apparent from the following excerpt from the opinion of Mr. Justice Bean:

> "From the facts as so stipulated, it is apparent that the mortgages were originally invalid, but the position of the defendant is that the possession taken by him in pursuance of the terms of the mortgage before the adjudication and before other creditors had seized the property cured the defect. The effect of a mortgagee taking possession of property covered by a mortgage like the one in question has been much discussed by the courts, and there is not entire harmony in the decisions. It seems to depend on whether the mortgage is regarded as fraudulent in fact and void ab initio, or only presumptively fraudulent. In Oregon such a mortgage is held to be fraudulent in fact and from the beginning, for the reason as stated by Mr. Justice Moore in Fisher vs. Kelly, 30 Ore. 1, 46 Pac. 146: "It is for the mortgagor's own use and benefit."
>
> (Citing Orton vs. Orton, 7 Ore. 478, and other Oregon cases. * * * *
>
> Where such a rule prevails, the courts generally hold that possession taken by the mortgagee does not purge the original transaction of its fraudulent character, because a void instrument cannot be the

> foundation of a valid lien." Citing numerous cases.

The next minor sub-division adopted by the Appellant is thus stated:

> "(d) Even without a change of possession, an unrecorded mortgage given in good faith is good against every one but subsequent purchasers and mortgagees in good faith and for a valuable consideration of the same personal property."

It is then argued that inasmuch as Section 7407, L. O. L., declaring invalid instruments intended to operate by way of mortgage, where same are not recorded, and there is no immediate change of possession, *limits* the class as to which the invalidity results, to subsequent purchasers and mortgagees in good faith and for a valuable consideration; the trustee not being a member of this class, the failure to record or transfer possession does not concern the trustee.

Reliance is placed by Appellant on the case of Williams vs. Bank, 48 Oregon 571, in which the Court held that one who had *actual notice* of a prior mortgage, even though unrecorded, could not claim to be a mortgagee in good faith. Appellant is apparently oblivious of the fact that in the case of Williams vs. Bank, there was *no* question as to the *validity* of the mortgage. The only question was whether an otherwise valid mortgage should be held void as to a subsequent mortgagee who

had *actual* notice of the prior valid mortgage, though the latter was not recorded.

Manifestly we are not concerned with any such question. It is constantly to be borne in mind that in none of the Oregon cases declaring chattel mortgages on shifting stocks of goods, with unrestrained possession of the mortgagor, either by the terms of the instrument or in actual practice, void for reasons of public policy, is the question of recordation or non-recordation even remotely involved. In point of fact, as heretofore stated, in Bremer vs. Fleckenstein and kindred cases, the mortgage *was* recorded. See also Scaupp vs. Miller, 206 Fed. 575.

While it is believed that this sufficiently answers the contention of the Appellant in this regard, we respectfully call the Court's attention to Section 799, L. O. L., which provides that every assignment of personal property by way of security, unless the same be accompanied by immediate, actual and continued change of possession, is presumed to be fraudulent not only as to mortgagees and purchasers, but as to the "creditors of the seller, or assignor, during his possession."

However, we reiterate that the reason the bank's claim of lien is without merit is *not* because of any statutory provision as to recordation, but because of a *basic equitable principle* followed in practically every state in the Union, with or without express provision of statute, and based upon the principles of common honesty and fair dealing. As was said In re Rasmussen, 176 Fed. 704, commenting upon the case of Orton vs. Orton, 7 Ore. 478:

> "In this decision the Court merely enforced a rule of general application—that a possession that is inconsistent with the conveyance is a fraud in law. And the rule is necessarily the same whether the possession is retained by the vendor, or is transferred to the vendee, contrary to the conditions of the sale or inconsistently with its purpose.
>
> The property claimed in the present case was delivered to the bankrupt with the intention that it should be sold by him in the course of his business as a merchant. The bankrupt's possession was in itself inconsistent with the express terms of some of the agreements of sale, and its purpose was inconsistent with all of them."

III.

THE AUTHORITY OF THE TRUSTEE TO MAINTAIN THIS SUIT.

This point is discussed by the Appellant under the heading:

> "The trustee is without authority to maintain this proceeding."

(The argument in this regard has no reference to the *nature* of the proceeding which was the subject of stipulation, and specifically concurred in by Appellant's Answer.)

The contention of the Appellant in this connection is that no creditor had secured a lien upon the personal property at the time the bank took possession of it an hour before the levy of the attachment, and hence the trustee secured no greater rights than the bankrupt himself had. The trustee, contends the Appellant, simply stood "in the shoes of the bankrupt."

What Appellant really means and what some of the decisions and some of the text-writers employing similar language loosely, really mean, is that the trustee, as to property not reduced into possession, does not have the rights of a creditor holding a *lien* upon that particular property.

It was never the law before the Amendment of Section 47 (a) of the Bankruptcy Act in 1910, and certainly not since the Amendment of 1910, that the trustee did not have the rights of an ordinary, simple contract creditor of the bankrupt. The trustee, as a matter of fact, represents the creditors and stands "in the shoes of the creditors." If a proposition which is apparently axiomatic needs demonstration, it would be a simple matter to sustain the accuracy of this statement, but it is believed that the statement suffices.

The whole Argument of Appellant in this connection is based on the assumption that the instrument construed as a mortgage is invalid only as to lien creditors. This is its major premises. The trustee, says Appellant, is not a lien creditor under the Amendment of 1910. This is its minor premise, and its conclusion naturally follows that the trustee "is clearly without authority to maintain this proceeding."

The only weakness of the syllogism is the utter incorrectness of the major premises, but this defect greatly

impairs the value of the conclusion. Thus, in the case of In re Flatland, 196 Fed. 310, the opinion dealing with the right of a trustee to attack a mortgage, specifically excepts from its operation cases where the disposition of property by the bankrupt was void because fraudulent. In the Flatland case the lien under attack was conceded to be a valid, equitable lien.

The precise contention made by Appellant, i. e., that the invalidity is only as to lien creditors, was raised and answered by the Supreme Court of Oregon in the case of Jacobs Bros. vs. Ervin, 9 Ore. 52. There a mortgage has been executed and the mortgagor retained unlimited power of disposition without accounting. Subsequently the mortgagor made a general assignment. The mortgagee, resisting the claims of the assignee, contended that even though the mortgage was void under the doctrine of Bremer vs. Fleckenstein, yet the assignee, being subrogated to the rights of *general creditors*, only, and there being no lien creditors, the assignee had no standing in court. The Supreme Court thus answered this contention at page 59:

> "The right of the general creditors to impeach or resist a fraudulent transfer or incumbrance attaches to the property, and we can conceive no inconsistency in holding that that right vests in the assignee under the assignment which they have assented to. He is the trustee of the creditors, as well as of the debtor, and holds the property assigned to him in trust for the payment of their claims against the debtor. With their consent he has taken the title and possession of the property and represents the interest which they have in it,

> and it would be a narrow construction, indeed, that would deny that he represents their whole interest; especially would this be the case where it so plainly appears, as it does in such cases as the present, that such a power is necessary, in a vital degree, to enable him to effectually administer his trust."

The Court said further in that case that it had not been cited to nor had it been able to find a *single decision denying to the assignee under a voluntary assignment, even at common law,* the right to resist the enforcement of a mortgage, valid as to the assignor, but void as to creditors, against the trust property.

If this is true, even as to a general assignee under a State Insolvency Law, or at common law, nominated by the insolvent debtor, it is, *a fortiori,* true of the Trustee in Bankruptcy selected by the *unsecured general creditors,* and being in contemplation of law, the creditors incarnate.

The case of In re Rasmussen, 136 Fed. 714, arising in Oregon, and which has been several times cited herein, was decided in 1905 prior to the 1910 Amendment of Section 47 (a) of the Bankruptcy Act giving the trustee the rights of a lien creditor as to property coming into his hands and the rights of a judgment creditor with an execution returned unsatisfied, as to property not coming into his hands. The Court did not, however, in that case hesitate to nullify the instrument at the instance of the trustee, though this trustee did not have the rights of a lien creditor or of an execution creditor.

The 1910 Amendment of Section 47 (a) was en-

acted to *extend* and *broaden* the powers of the trustee. The Appellant here is asking for a construction which would give to the 1910 Amendment the purpose and effect of *narrowing* the rights of the trustee, and the creditors represented by him.

If the trustee had the right to attack an invalid instrument before the 1910 Amendment to Section 47 (a), surely that right has not been diminished by that Amendment which evinces the intention of Congress to strengthen the trustee's position!

A most apposite statement with regard to the position of the trustee here will be found in the Second Edition of Remington on Bankruptcy, Sec. 1127 3-4, page 1064, in which that leading authority on the subject, says:

> "Where the state law invalidates a transaction as against any existing creditor, whether armed with process or not, then the trustee will be subrogated to the right of any such existing creditor, regardless of the Amendment of 1910, arming him with process."

The Appellant also loses sight of the fact that other sections of the Bankruptcy Act are to be considered in this connection. The importance of these sections and their bearing on this case are clearly pointed out in the thorough report of the Special Master (Transcript of Record, pp. 32-47.)

The Special Master calls attention to Section 70a (5) reading:

> "The trustee * * * shall be vested by operation of law with the title of the bankrupt to all * * * (5) property which, prior to the filing of the petition, he could, by any means, have transferred, or which might have been levied upon and sold under judicial process against him."

As to which Remington on Bankrupty says:

> "Chattel mortgages with power of sale are void as against the trustee if there is no agreement that the proceeds be applied on the debt, where such mortgages are held void as to the creditors by the law of the state.
>
> "The goods which the chattel mortgage thus authorizes the bankrupt to sell must pass to the trustee under Sec. 70 as being property which the bankrupt might have transferred before the bankruptcy."

Remington's statement in this regard is supported by In re Rasmussen, 136 Fed. 704, 706, where it is said with reference to this section:

> "If the provision of the Bankruptcy Act which vests in the trustee property which prior to the filing of the petition the bankrupt 'could by any means have transferred,' is to have any application, it must operate to vest the property claimed in this case in the trustee."

And Section 67a of the Bankruptcy Act reads as follows:

> "Claims which, for want of record, or for other reasons, would not have been valid liens as against the claims of creditors of the bankrupt, shall not be liens against his estate."

An instructive case completely answering the contention of the Appellant in this regard is that of Mitchell vs. Mitchell, 12 A. B. R. 389, in which the Court said with reference to a mortgage which was valid between the parties, but fraudulent as to creditors.

> "The title attempted to be passed by such mortgage vests in such trustee. He stands in the shoes of the bankrupt, but *represents the creditors,* and is entitled to possession, and may bring an action to enforce his right of possession. He can maintain any action *either could maintain.* Such an action is not analogous to a creditor's bill, and *it is no objection to it that the claims against the bankrupt are not in judgment.* The title is vested in him by operation of law. * * * * *
>
> It is argued that the mortgage in controversy being good as between the parties is also good as between the mortgagees and trustee in bankruptcy of the mortgagor; but *the rule is well settled that the trustee represents the rights of creditors,* and may attack conveyances made by the bankrupt in fraud of creditors. It is so provided in the statute. The trustee may prosecute any suit to recover assets in the hands of third parties, or to enforce the payment of claims that could have been prosecuted by the creditors themselves

> had no proceedings in bankruptcy been instituted." (Italics ours.)

The case of Mitchell vs. Mitchell was decided before the 1910 Amendment of Section 47 (a).

We quote again from the report of the Special Master in this regard: (Transcript of Record, p. 42.)

> "I do not think it necessary for the trustee to plant his case upon this section (47a) but, if it were, the weight of authority is that it is not required there should be in fact creditors with the designated liens, but rather, that the trustee is deemed to have, and, in very truth, is invested with, the potential right of such creditors; the intendment is simply that his rights are to be measured by the rules of law applicable in the case of creditors who might have obtained these advantages. This must be so, for, as one authority puts it, 'If the operation of the amendment is restricted to cases in which a creditor has in fact acquired a lien by legal or equitable proceedings, then it adds nothing to the law as it was under the orginal act?
>
> In re Colhoun Supply Co., 26 A. B. R. 528, 189 Fed. 537."

The learned Judge of the District Court below, in passing upon this contention of Appellant, said: (Transcript of Record, pp. 79-80.)

> "It is also claimed the Trustee in Bank-

> ruptcy is not in position to question the validity of this instrument. Prior to the Amendment of 1910 to the Bankruptcy Act the trustee was not clothed with the privilege of a judgment creditor, but to obviate this condition the amendment of 1910 was adopted, which was intended to vest in the trustee the same rights to attack secret unrecorded liens which were void under the state statute as was given to a judgment creditor under a state law. And under that provision of the Bankrupty Act I take it that the Trustee in Bankruptcy is in position to question the validity of this mortgage, *which was void from the beginning*, and therefore the decision of the Referee in Bankruptcy will be affirmed."

CONCLUSION.

In what the Appellant terms its "Conclusion," pages 26-27 of its Brief, it urges that it would be a "harsh law" which would defeat the bank's right to the proceeds of this property. If the rule is "harsh" as to the bank it was made so by the bank itself. That the bank was familiar with the equitable principle which prevents it from enabling Sondheim to hold his property free from the claims of creditors, by virtue of the existence of a chattel mortgage designed to enable him to retain the proceeds of his sales, without accounting or applying same in reduction of the mortgage, appears from internal evidence—the terms of the instrument in controversy.

Certainly the bank cannot call it a "harsh law" which gives the creditors the right to say to the bank after taking such an instrument, that it see to it vigilantly that as fast as sales are made by Sondheim the proceeds be accounted for and applied in reduction of the indebtedness to the bank.

As a matter of fact the instrument itself provides that Sondheim should pay over to the bank only *one-half* of the proceeds. What was to become of the other half? Naturally Sondheim could use it. In actual practice, however, he was not required to account even for one-half of the proceeds, but a convenient arrangement was entered into by which he might pay the bank $500 per week, though his sales might have run into the thousands, and yet if the bank's view be correct, it would be a "harsh law" which would permit the creditors to object to any such arrangement!

That the course of conduct of the bank and Sondheim in this matter, irrespective of the bank's contentions, constituted a fraud upon the rights of creditors is not open to doubt; that the Oregon law which governs in the matter as expounded in the decisions of the Supreme Court of the State of Oregon denounces such a transaction as fraudulent *per se* is not open to doubt; that under this course of decisions the objection to the validity of such an instrument can be raised by an assignee or trustee representing the general creditors, is not open to doubt; that a trustee in bankruptcy has, under the Bankruptcy Law, rights equal to the assignee, a common law is not open to doubt.

We respectfully submit that it must therefore be concluded that the proceeds of the sale of the property

involved is a part of the general estate of the bankrupt in which the bank must share along with other creditors, without preference or priority. Such was the view of the Special Master, and such was the view of the learned Judge of the lower court.

We respectfully commend to the attention of this Court the scholarly and exhaustive opinion of Special Master A. M. Cannon, Esq., set out in extenso in the Transcript of Record, at pages 32-47, and bearing internal evidence of intelligent, careful, conscientious investigation and deliberation. Every phase of the matter was so thoroughly covered in the Master's report that Mr. Justice Bean, approving same, deemed it unnecessary to discuss at length the questions involved, and contented himself with a brief incisive statement of his conclusions.

Respectfully submitted,

SIDNEY TEISER,

ROSCOE C. NELSON,

Attorneys for Trustee and Appellee.